

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

ADJUSTMENT OF THE RATES OF)
AUXIER ROAD GAS COMPANY, INC.,) CASE NO. 8768
FOR AN INCREASE IN GAS RATES)

O R D E R

On March 28, 1983, Auxier Road Gas Company, Inc., ("Auxier Road") filed its notice proposing to increase the rates and charges for gas service rendered to its customers after April 17, 1983, and requesting interim rate relief. The proposed increase would produce \$86,640 in additional revenue or an increase of 17.38 percent. On March 31, 1983, the proposed rates and charges were suspended for 5 months after April 17, 1983.

On May 4, 1983, the Commission held a public hearing to consider Auxier's request for interim rate relief, and on June 6, 1983, the Commission granted the interim rates subject to refund. In order to determine the reasonableness of Auxier Road's request for permanent rate relief another public hearing was held on June 21, 1983. The Consumer Protection Division of the Attorney General's Office participated in both hearings. The Auxier Community Development Club participated in the latter hearing.

In this Order, the Commission has allowed an increase in operating revenues of \$32,147.

TEST PERIOD

Auxier Road proposed and the Commission has accepted the 12-month period ending December 31, 1982, as the test period in this matter.

VALUATION METHOD

Auxier Road proposed a net investment rate base of \$443,062.^{1/} The Commission has accepted the proposed rate base with the following modifications:

Utility Plant/Transportation Expense

There was considerable testimony at the hearing regarding the purchase of a 1978 Lincoln Continental by Auxier Road. Auxier Road's President, Mr. Estill Branham, testified that the vehicle was purchased from Auxier Road's Secretary, Sallye Branham, for \$5,500; that the vehicle was previously used in Auxier Road operations prior to its purchase on January 1, 1982; and that the vehicle had been driven approximately 60,000 miles at the time of purchase.^{2/} During cross-examination, Mr. Branham admitted that Auxier Road also owned three additional vehicles despite having only three employees and that the Lincoln was purchased after restoration of the system was completed in 1981.^{3/} Mr. Branham further testified that the vehicle was used primarily by Sallye Branham to go to the post office and the bank, although it was also used on out-of-town trips.^{4/}

The Commission is not convinced of the necessity of this vehicle in the operations of Auxier Road. The Commission will accept the proposed transportation expense, which includes the daily expenses of operating this vehicle, although the Commission

is concerned with the increasing amount of this expense and advises Auxier Road that this expense will be closely scrutinized in future rate cases. Because the Commission is of the opinion that the transaction which resulted in the inclusion of the vehicle in the plant accounts was less than arms-length and was not proven to be a prudent and necessary investment to be charged to the ratepayers, the Commission has excluded the net cost of this item in the determination of the rate base, which results in a reduction in rate base of \$3,850.^{5/}

Cash Working Capital

Auxier Road proposed to include a cash working capital allowance of \$16,300 in its proposed rate base. The Commission has reduced this amount by \$2,393^{6/} in order to allow one-eighth of the adjusted operating and maintenance expenses less purchased gas found appropriate herein.

Depreciation Reserve

The Commission has decreased Auxier Road's depreciation reserve by \$7,220 in order to reflect the pro forma adjustments to depreciation expense found appropriate herein.

Thus the Commission has determined Auxier Road's net investment rate base to be as follows:

Utility Plant	\$532,298
Prepayments	4,420
Working Capital	13,907
Subtotal	<u>\$550,625</u>
Less:	
Depreciation Reserve	\$ 99,586
Customer Advances	8,650
Subtotal	<u>\$108,236</u>
Net Investment Rate Base	<u><u>\$442,389</u></u>

REVENUES AND EXPENSES

Auxier Road had net operating income of \$647 for the test period. In order to reflect current operating conditions, Auxier Road proposed numerous adjustments to revenues and expenses resulting in an adjusted net operating loss of \$51,139. The appropriate level of net operating income as determined by the Commission after consideration of the proposed adjustments is \$3,397.

The Commission has accepted Auxier Road's pro forma revenues and expenses with the following adjustments:

Normalized Revenues

Auxier Road proposed a pro forma level of revenues based on test period revenue adjusted for temperature normalization of \$556,326.^{7/} Auxier Road's temperature normalization was calculated using the rates proposed in this filing. The Commission has increased revenues by \$4,004 using the rates current at the filing date^{8/} because usage of the proposed rates would overstate the amount of revenue earned above that normally expected during the test period as a result of temperature variance.

Purchased Gas Expense

Auxier Road proposed a pro forma purchased gas expense of \$431,075.^{9/} Auxier Road calculated its purchased gas cost and its temperature normalization assuming 5 percent line loss, although for the test period there was a net gain. Since no line loss was experienced during the test period, this factor has been

disallowed in the calculations, which results in a reduction in Auxier Road's pro forma purchased gas expense of \$20,910.^{10/}

Salaries, Wages and Benefits

Auxier Road proposed an adjustment of \$9,874 to increase the salaries and wages of its three employees. Auxier Road cited inflation and the need for wage parity with industry as justifications for the proposed increases. Auxier Road's total pro forma expenses for salaries, wages and benefits proposed was \$72,033,^{11/} including pensions and benefits of \$9,375 and miscellaneous labor of \$876.^{12/} The proposal in this case represents an increase in base salaries and benefits of 37 percent in the 2 years since the Order in Auxier Road's last case, Case No. 7897, which allowed adjusted wages, salaries and benefits of \$52,486.^{13/} The Commission is particularly concerned with the pensions and benefits expenses, which increased from \$2,400 in Case No. 7897 to \$9,375 in the test period. Furthermore, the proposed amount does not include bonuses totalling \$2,660^{14/} and directors fees of \$900 which were paid to two employees during the test period.

Auxier Road's proposal included labor increases to various operation and maintenance expense accounts, as well as increases to administrative and general salaries. The Commission is of the opinion that there is substantial evidence in the record to indicate that these expenses should be reduced rather than increased. Auxier Road is currently benefiting from a reconstructed system as evidenced by a net gain in line loss during the test year; thus less maintenance should be required.

Auxier Road's president had the highest salary of any president of Eastern Kentucky's private gas companies.^{15/} Further, it is obvious from a comparison between the wages, salaries, and benefits proposed in this case and those allowed in Case No. 7897 that the proposed increase greatly exceeds the inflation rate.

The Consumer Price Index ("CPI") is a primary measure of inflation and since September, 1982, its annual percentage increase has been 5 percent or less, declining to less than 4 percent annually through the end of April, 1983. The CPI is frequently used by industry in wage increases and the Commission finds it useful in analyzing wage and salary adjustments. Since the issuance of the Order in Case No. 7897 at the end of April, 1981, the CPI has risen by approximately 10.5 percent^{16/} The Commission is of the opinion that this is the maximum increase which should be passed on to Auxier Road's customers for wage, salary and benefits increases. Accordingly the Commission has reduced Auxier Road's pro forma wages, salaries and benefits expenses by \$10,771 to an adjusted level of \$57,997.^{17/}

The Commission realizes that benefits costs have increased in recent years. However, testimony regarding the specific reasons for increases was not presented in sufficient detail to allow the Commission to accept the substantial increases in benefits experienced since Case No. 7897. The Commission advises Auxier Road that if upon rehearing adequate justification for the proposed level of benefits can be provided, the Commission will reconsider these costs. However, the Commission further advises Auxier Road that if future increases in wages, salaries and

benefits are granted which the Commission determines to be excessive, the Commission will take appropriate action to insure that the customers of Auxier Road will not bear that portion of the increase found to be excessive.

Depreciation Expense

Auxier Road proposed a pro forma depreciation expense of \$31,073. At the hearing Auxier Road's accountant, Mr. Paul Branham, admitted an error in the computation of 1982 depreciation expense for meters in the amount of \$566.^{18/} Subsequent to the hearing, an additional error was discovered on the depreciation schedule. The 1982 depreciation expense for tools purchased at a cost of \$4,051 and depreciated at a 10 percent rate was \$891,^{19/} an overcharge of \$486. The correction of these two errors reduces depreciation expense by \$1,052.

Mr. Paul Branham was also questioned about the use of a 10 percent rate on restoration services. In Case No. 7897 services which were retired because of the system restoration were depreciated at a 3 percent rate.^{20/} Mr. Branham admitted that the previous system had a useful life of approximately 20 years and that the plastic pipe used in the system restoration had an indefinite life span.^{21/} The Commission finds it inappropriate to depreciate such pipe at a 10 percent rate and has reduced depreciation expense by \$4,518 to reflect the depreciation of these services at the 3 percent rate used before reconstruction.

Finally, a further reduction in depreciation expense of \$1,650 has been made to eliminate depreciation expense on the previously discussed vehicle which was removed from the rate base.

The total reduction in depreciation expense because of these adjustments is \$7,220.

Miscellaneous General Expenses

In response to Commission requests Auxier Road supplied a breakdown of items totalling \$6,749 which were grouped as miscellaneous general expense.^{22/} The following adjustments have been made to these expenses:

- (a) Charitable contributions of \$73, while insignificant, have been disallowed in accordance with Commission policy that ratepayers should not be required to pay such costs.
- (b) Directors fees of \$900 have been disallowed. Based on the current poor financial condition which Auxier Road's witnesses testified to, and the high level of salaries, the Commission is of the opinion that these charges are inappropriate, particularly since with one exception the directors and the employees are the same.^{23/}
- (c) Telephone and communications service for the test period was \$3,059, which included the cost of two lines and two telephones. Because Auxier Road has only two office employees and because these expenses are excessive, the Commission has disallowed the approximate cost of one telephone line, which reduces this expense by \$876.^{24/}
- (d) Miscellaneous labor costs of \$876 have been removed from proposed expenses because they were considered in

determining the total salaries and wages found appropriate herein.

Therefore, the Commission has reduced Auxier Road's adjusted operating expenses by \$2,725.

Mains and Services Supplies and Expenses

Auxier Road submitted invoices for expenditures in the mains and services supplies and expenses account in response to a Commission request. Among these expenditures was a \$421 expense for service line pipe. The Commission is of the opinion that this expenditure should be capitalized to Account 380 ("Services") of the Uniform System of Accounts for Class C Gas Utilities. Accordingly the Commission has depreciated this expense at a 3 percent rate, a reduction in operating expenses of \$408.

Uncollectible Accounts

Auxier Road's test period expenses included \$1,775 of uncollectible accounts attributed to two commercial customers, the Auxier Road Real Estate Company, Inc., ("Auxier Road Real Estate") and the B and S Market ("B and S"). During cross-examination, Auxier Road's president admitted that Auxier Road loaned equipment to Auxier Road Real Estate for which it was not compensated, and he agreed that the customers should not have to bear this cost of \$1,096.^{25/} Further testimony revealed that the uncollectible with B and S was recorded after B and S refused to pay for reconstruction of a service line;^{26/} that Auxier Road did not attempt to take legal action against B and S;^{27/} and that Auxier Road did not investigate the possibility of disconnecting gas service to B and S, which it is currently providing.^{28/} The

Commission is of the opinion that this amount should not be recorded as uncollectible until all possible attempts at collection have been exhausted. The Commission is further of the opinion that the customers of Auxier Road should not be required to bear this cost and has disallowed this expense for rate-making purposes. The disallowance of uncollectible accounts results in a reduction in adjusted operating expenses of \$1,775.

Therefore, the adjusted operations of Auxier Road are stated as follows:

	<u>Auxier Road Adjusted</u>	<u>Commission Adjustments</u>	<u>Commission* Adjusted</u>
Operating Revenues	\$ 556,326	\$ 4,004	\$ 560,330
Operating Expenses	<u>607,465</u>	<u>(50,532)</u>	<u>556,933</u>
Net Operating Income	<u>\$ (51,139)</u>	<u>\$ 54,536</u>	<u>\$ 3,397</u>

RATE OF RETURN

The Commission is of the opinion that a fair, just and reasonable rate of return on the Net Investment Rate Base should be 7.5 percent in that it will allow Auxier Road to pay its operating expenses, service its debt, and provide a reasonable surplus for equity growth.

REVENUE REQUIREMENT

Based on the rate of return found fair, just and reasonable and Auxier Road's adjusted operations, the required net operating income is \$33,179. Thus, the Commission has determined

*Income taxes not included in final computation.

that Auxier Road should be allowed to increase its rates and charges by \$32,147 annually, determined as follows:

Required Net Operating Income	\$33,179
Adjusted Net Operating Income	<u>3,397</u>
Deficiency	\$29,782
+ Income Taxes	<u>2,365</u>
Required Revenue Increase	<u>\$32,147</u>

Supplier Refunds

In response to the Commission's Order of May 23, 1983, Auxier Road stated that it had received refunds from its supplier, Columbia Gas of Kentucky, Inc., in the amount of \$64,622. Of this amount \$29,114 has been refunded to Auxier Road's customers leaving a balance of \$35,508 to be refunded. The Commission is of the opinion that Auxier Road should refund to its customers this amount plus the interest earned from the date the refunds were received.

FINDINGS AND ORDERS

The Commission, having considered the evidence of record and being advised, is of the opinion and finds that:

(1) The rates and charges proposed by Auxier Road should be denied upon application of KRS 278.030 in that they produce revenues in excess of those found fair, just and reasonable.

(2) The rates and charges in Appendix A are the fair, just and reasonable rates and charges to be charged by Auxier Road on and after the date of this Order.

(3) Auxier Road should capitalize the expenditure for service pipe in Account 380 ("Services") of the Uniform System of

Accounts for Class C Gas Utilities and depreciate this expenditure at a 3 percent rate.

(4) Auxier Road should refund to its customers the balance of supplier refunds plus interest earned from the date the refunds were received.

(5) The Commission's Interim Order of June 6, 1983, should be superseded by this Order.

(6) Within 30 days of the date of this Order, Auxier Road should file its revised tariff sheets setting out the rates and charges approved herein.

IT IS THEREFORE ORDERED that the rates and charges proposed by Auxier Road be and they hereby are denied upon application of KRS 278.030.

IT IS FURTHER ORDERED that the rates and charges in Appendix A be and they hereby are the fair, just and reasonable rates and charges to be charged by Auxier Road for service rendered on and after the date of this Order.

IT IS FURTHER ORDERED that Auxier Road shall capitalize and depreciate the expenditure for service piping.

IT IS FURTHER ORDERED that within 30 days of the date of this Order Auxier Road shall file a plan to refund its supplier refunds in the amount of \$35,508, plus accrued interest, to its customers.

IT IS FURTHER ORDERED that the Commission's Interim Order of June 6, 1983, be and it hereby is superseded by this Order.

IT IS FURTHER ORDERED that within 30 days of the date of this Order Auxier Road shall file its revised tariff sheets with this Commission setting out the rates and charges approved herein.

Done at Frankfort, Kentucky, this 16th day of September, 1983.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

FOOTNOTES

1. Application and Notice, Exhibit 2, page 1.
2. Transcript of Evidence ("T.E."), June 21, 1983, page 34.
3. T.E., pages 58-59.
4. T.E., page 49.
5. Commission staff request, May 27, 1983, Item 6, page 1.
6. $1/8 (\$521,423 - \$410,165) = \$13,907; \$16,300 - \$13,907 = \$2,393.$
7. $(\$571,318 - \$30,553 = \$540,765) + \text{Other Revenue } (\$15,561) = \$556,326.$
8. $(\$9.050 - \$7.864) (\$3,376 \text{ Excess MCF}) = \$4,004.$
9. Purchases $(\$451,998) - \text{Temperature Adjustment } (\$20,924) = \$431,075.$
10. $(\$71,555) (\$6.016) - (\$3,376 \text{ Excess MCF}) (\$6.016) = \$410,165; \$431,075 - \$410,165 = \$20,910.$
11. $\$61,782 (\text{Salaries and Wages}) + \$9,375 (\text{Benefits}) + \$876 (\text{Misc.}) = \$72,033.$
12. T.E., page 170.
13. Case Number 7897, Order entered April 23, 1981, page 7.
14. Commission staff request, May 27, 1983, Item 3.
15. Staff Exhibit #1 submitted at June 21, 1983, hearing.
16. Increased CPI-W from May, 1981, to June, 1983 = $28.2 \div 269 = 10.48$ percent.
17. $(\$52,486) (\$1.105) = \$57,997.$
18. T.E., page 142.
19. Commission staff request, May 27, 1983, Item 6, page 2.
20. Case Number 7897, response to Order of November 7, 1980, Appendix 4, sheet 1.
21. T.E., page 144.
22. Commission staff request, May 3, 1983, Item 3.

23. T.E., pages 51-52.

24. \$73 (1/2 of local monthly service cost) X 12 = \$876.

25. T.E., page 77.

26. T.E., page 78.

27. T.E., page 62.

28. T.E., page 78.

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 8768 DATED SEPTEMBER 16, 1983

The following rates and charges are prescribed for the customers served by Auxier Road Gas Company, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

RATES: Monthly

First	1,000 cu. ft.	\$8.895 Minimum Bill
All Over	1,000 cu. ft.	8.095 per 1,000 cu. ft.

The above rates have incorporated the rates established in PGA Case Nos. 7897-P, 8768-A and 8768-B.